



# Orchid Island Capital, Inc. (ORC)

Updated May 13<sup>th</sup>, 2023 by Samuel Smith

## Key Metrics

<b>Current Price:</b>	\$10.1	<b>5 Year CAGR Estimate:</b>	10.9%	<b>Market Cap:</b>	\$390M
<b>Fair Value Price:</b>	\$10.4	<b>5 Year Growth Estimate:</b>	-2.8%	<b>Ex-Dividend Date:</b>	5/30/23
<b>% Fair Value:</b>	97%	<b>5 Year Valuation Multiple Estimate:</b>	0.6%	<b>Dividend Payment Date:</b>	6/28/23
<b>Dividend Yield:</b>	19.0%	<b>5 Year Price Target</b>	\$9.0	<b>Years Of Dividend Growth:</b>	0
<b>Dividend Risk Score:</b>	F	<b>Retirement Suitability Score:</b>	C	<b>Rating:</b>	Buy

## Overview & Current Events

Orchid Island Capital, Inc. is a Real Estate Investment Trust, or REIT, operating in the mortgage industry. Mortgage REITs differ from most other REITs. For example, traditional REITs typically own a portfolio of physical real estate, which they lease to tenants to collect rental income. Mortgage REITs are purely financial entities, and Orchid Island does not own any physical properties. Instead, it is an externally managed REIT (by Bimini Advisors LLC) that invests in residential mortgage-backed securities (RMBS), either pass-through or structured agency RMBSs, which are financial instruments that collect cash flow based on residential loans such as mortgages, including subprime, and home-equity loans.

On April 27<sup>th</sup>, 2023, Orchid Island Capital reported Q1 results. Orchid reported a net income of \$3.5 million, or \$0.09 per common share, in the first quarter. This included net interest expense of \$4.2 million and total expenses of \$5.0 million.

However, the company also recorded net realized and unrealized gains of \$12.7 million on RMBS and derivative instruments, contributing to earnings. The first quarter dividends declared and paid amounted to \$0.48 per common share. The book value per common share stood at \$11.55 as of March 31, 2023. The total return for the quarter was 0.84%, calculated by dividing the dividends per common share and the decrease in book value per common share by the beginning book value per common share.

Orchid maintained a strong liquidity position, with \$197.0 million in cash, cash equivalents, and unpledged RMBS, which represented 44% of stockholders' equity as of March 31, 2023. The company also had borrowing capacity exceeding its outstanding repurchase agreement balances of \$3,769.4 million, spread across 20 active lenders.

## Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
<b>BPS</b>	\$67.00	\$65.30	\$58.20	\$50.50	\$43.55	\$34.20	\$31.35	\$27.30	\$21.70	\$11.93	<b>\$11.55</b>	<b>\$10.00</b>
<b>EPS</b>	\$10.64	\$12.28	\$12.52	\$12.95	\$11.34	\$6.92	\$4.29	\$5.98	\$4.64	\$2.20	<b>\$1.40</b>	<b>\$1.40</b>
<b>DPS</b>	\$6.98	\$10.80	\$9.60	\$8.40	\$8.40	\$5.35	\$4.80	\$3.95	\$3.90	\$1.14	<b>\$1.92</b>	<b>\$1.40</b>
<b>Shares<sup>1</sup></b>	1.7	3.3	4.4	6.6	10.6	9.7	13.0	17.0	35.4	39.1	<b>39.1</b>	<b>45.0</b>

Orchid Island has experienced extreme earnings volatility over the past several years, with a net loss in 2013 and 2018, along with multiple years in which the trust barely generated a profit. As a result, we are using book value per share as an alternate metric to earnings-per-share. The growth outlook for mortgage REITs is challenged. Mortgage REITs make money by borrowing at short-term rates and lending at longer-term rates, then pocketing the difference. This is referred to as the spread, which is how Orchid Capital generates its cash flow.

When the spread between short-term rates and long-term rates compresses, profitability erodes at a rapid pace. This is why mortgage REITs can be dangerous if the yield curve flattens. Moving forward, we expect the book value per share to recover in the coming years, though the high payout will result in weakening earnings per share and dividends per share.

<sup>1</sup> In millions

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## Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/B	0.9	1.0	1.0	1.0	1.2	0.9	0.9	1.0	0.9	0.9	<b>0.9</b>	<b>0.9</b>
Avg. Yld.	11.2%	16.4%	16.8%	16.3%	16.5%	16.8%	16.8%	14.2%	19.1%	10.6%	<b>19.0%</b>	<b>15.6%</b>

Since we are using book value instead of earnings-per-share, we will also use the price-to-book ratio for valuation instead of the price-to-earnings ratio. The stock presently has a price-to-book ratio of 0.90, compared with our fair value estimate of 0.9 which accounts for uncertainties and risks facing the business.

Some investors may be enticed by the extremely high dividend yield for the stock, which drives the investment thesis. However, we offer two cautionary notes. First, the dividend has already been cut multiple times since 2015. Second, and just as important, is that despite an exceptionally high starting yield, total returns can be dampened significantly by the erosion in the share price as time goes on. This idea is underscored by the virtually nil total returns since the security's inception, despite carrying a double-digit dividend yield throughout this period.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

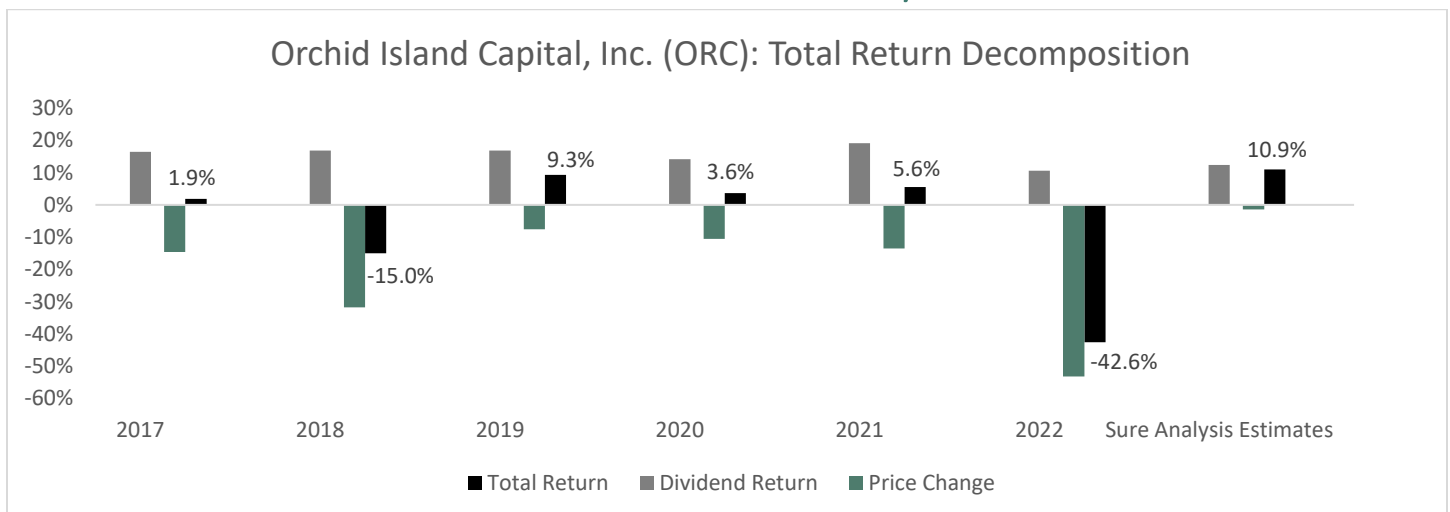
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	66%	88%	77%	65%	74%	77%	112%	66%	84%	52%	<b>137%</b>	<b>100%</b>

Orchid Island is not a safe stock. The above payout ratios are extreme due to low or non-existent earnings. Mortgage REITs are exposed to a number of risks, including interest rate risk, as well as credit risk. These risks pertain to the direction of interest rates, as well as the ability of borrowers to repay the mortgage loans. Moreover, mortgage REITs do not possess many competitive advantages. Since mortgage REITs do not provide differentiated products and services, traditional competitive advantages such as brand power or manufacturing efficiencies do not apply. In addition, Orchid Island is not a recession-resistant trust. A recession generally leads to higher mortgage defaults.

## Final Thoughts & Recommendation

Orchid Island Capital offers an extremely attractive dividend yield. That said, it is an extremely risky stock due to its track record of consistently destroying shareholder capital and slashing its dividend repeatedly. Given that the economy is facing growing risks and headwinds, we expect book value and dividend erosion in the coming years, leading to expected annualized total return potential of 10.9%. We therefore rate the stock to be a speculative Buy.

## Total Return Breakdown by Year



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## Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	1	29	9	11	13	(32)	35	13	(50)	(238)
SG&A Exp.	1	4	7	8	9	9	8	8	13	3
Net Profit	(1)	25	1	2	2	(44)	24	2	(65)	(258)
Net Margin	-72.0%	84.5%	11.9%	17.9%	15.2%	137%	70.0%	16.8%	131%	108.7%
Free Cash Flow	10	12	31	47	85	94	48	55	96	289

## Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	364	1,658	2,242	3,139	4,023	3,396	3,882	4,058	7,069	3,866
Cash & Equivalents	8	93	57	73	214	108	194	220	385	206
Accounts Receivable	2	6	8	12	14	13	12	10	19	12
Total Liabilities	319	1,440	1,989	2,806	3,561	3,060	3,487	3,643	6,301	3,427
Accounts Payable	0	1	1	2	7	6	11	1	1	9
Long-Term Debt	-	-	188	-	-	-	-	-	-	-
Shareholder's Equity	45	218	253	333	462	336	396	415	768	439

## Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	-0.3%	2.4%	0.1%	0.1%	0.1%	-1.2%	0.7%	0.1%	-1.2%	-4.7%
Return on Equity	-2.3%	18.7%	0.5%	0.7%	0.5%	-11.1%	6.6%	0.5%	-10.9%	-42.8%
ROIC	-2.3%	18.7%	0.3%	0.5%	0.5%	-11.1%	6.6%	0.5%	-10.9%	-42.8%
Shares Out.	1.7	3.3	4.4	6.6	10.6	9.7	13.0	17.0	35.4	33.4
Revenue/Share	0.32	2.93	0.44	0.46	0.32	(0.62)	0.62	0.19	(0.41)	(6.35)
FCF/Share	3.35	1.18	1.52	1.95	2.07	1.80	0.86	0.82	0.80	7.72

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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